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SUBJECT: ROMANIA: A 'EUROPEAN' MODEL FOR THE ENERGY SECTOR

REF: A) Bucharest 440

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1. (SBU) Summary: The Government of Romania (GOR) is considering the creation of two vertically integrated energy companies formed out of existing state-owned assets, reversing a decentralization process that the GOR now sees as having been flawed. Instead, two "national champions" able to compete on the wider European energy market will be fostered. If approved, the entities will each include enough production, generation, and distribution assets to account for 90 percent of the Romanian energy market. U.S. and other multinational companies have raised competition concerns with regard to this proposal, which seems to have been driven by political, not economic, considerations. End Summary.

2. (SBU) The proposal to develop two "national champions" was first mooted for post in a meeting between the Charge d'Affaires and the Minister of Economy (reftel). Conversations with lower level interlocutors have revealed additional details of the Ministry of Economy's (MoE) plans. Under the Ministry's proposal, the first entity would bundle the two operational nuclear reactors with two hydro power stations, several coal-fired power plants, and the national hard-coal mining company. The second entity would bundle natural gas producer Romgaz with the remaining hydro power stations, all natural gas fired power plants, the lignite fired power plants, and the lignite mining companies. Both companies would also include distribution. Notably absent from this mix is any renewable or alternative energy generation component, with the exception of a legal mandate to purchase "green certificates" on the market. Since neither of the integrated companies will include renewable generation, continued growth will depend entirely on the private sector, which in the absence of feed-in tariffs or mandated renewable production quotas, may struggle to sell power to the integrated companies' distributors. This, coupled with the perpetually delayed implementing regulations for Romania's renewable energy law, could slow-down expansion plans in this booming sector.

3. (SBU) The American Chamber of Commerce (AmCham) recently hosted a meeting with Alexandru Sandulescu, Director General of the Energy Policy Directorate in the MoE, to discuss energy policy, focusing on the proposal to "integrate" the state-owned companies. The meeting was revealing in that Sandulescu repeatedly referred to the proposal as a "political" one that was made without the involvement of professional Ministry staff. Speaking candidly, Sandulescu shared his concerns about possible flaws in the bundling proposal. In his opinion, the inclusion of reactors 1 and 2 of the Cernavoda nuclear power plant in one of the new entities would make it harder for the nuclear power company Nuclearelectrica to finance reactors 3 and 4, which are currently under construction. Another concern is with the integration of energy distribution, raising the possibility of an EC infringement procedure unless distribution is somehow cordoned off from the rest of the business.

13. (SBU) The cost assumptions underlying the MoE's proposal are also questionable. The MoE has publicly stated that the companies will have an average cost of 44 to 45 euro per MWh. However, these estimates are based on 2006 data and do not factor in the mining industry coal subsidies that will be included in the price of electricity as of 2010, nor do they include the cost of CO2 allowances, which will be required starting in 2013.

14. (SBU) Potential private sector competitors to the new companies are worried about the market implications of having two state-owned and operated companies controlling 90 percent of the energy market. These concerns have spurred Romania's Competition Council (RCC), to announce that it will scrutinize the plan closely. EU Energy Commissioner Piebalgs has also publicly advised Romania against taking measures that would reduce competition on the power market. Still, the plan appears to have legs, with the MoE issuing a string of press releases over the last month making the case for the plan. As the MoE sees it, Romania's energy sector was wrongly decentralized according to generation type. This has left the market fragmented and unable to make needed investments in the future. It has also contributed to a situation where very little energy is traded over the energy exchange, as both the energy producers and major consumers have an incentive to lock in non-transparent long-term bilateral contracts. The MoE also admits to wanting to build companies big enough to compete throughout Europe, like many of the "national champions" in neighboring states. Left unsaid are the underlying goals of reasserting stronger state control over a strategic sector and protecting employment by allowing cheap hydro-power to subsidize the jobs of coal miners and inefficient thermal power plants.

15. (SBU) Comment: The final shape of the MoE's proposal is still under discussion and the jury is still out as to the ultimate

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impact. Particular points of concern are the integration of distribution and the lack of a well thought-out plan for encouraging the new companies to develop renewable generation capacities. The non-transparent way that the plan has been drafted and the MoE's unwillingness to engage with a broad range of stakeholders bode ill for the proposal. Another worrying factor is the top-down manner in which the proposal was developed, with little input from career technical staff at the MoE. That being said, if distribution can be firewalled off from production and if integration is a prelude to privatization then the proposal may yet end up positively. Unfortunately, given the way this proposal has developed so far, its overall impact will likely be negative, both for the private sector and for Romania's commitment to reduce greenhouse gas emissions. End comment.
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